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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

TENNY ROSS, *Petitioner*

v.

UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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TENNY ROSS, *Petitioner*

v.

UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Claims entered in the above-entitled case.

CITATION TO OPINION BELOW

The Opinion of the United States Court of Claims is unreported. A copy of its Opinion, Judgment, Findings of Fact and Conclusions of Law is printed as Appendix "A" to this petition.

JURISDICTION

The Judgment was entered June 3, 1959. The jurisdiction of the Court is invoked under Title 28 U.S.C. Sections 1255(1) and 2101(c).

QUESTION PRESENTED

When the petitioner, a shareholder of The Washington Loan and Trust Company of Washington, D. C., received money in addition to stock pursuant to the consolidation of The Washington Loan and Trust Company and The Riggs National Bank of Washington, D. C., was such money taxable to the petitioner as a gain under Section 356(a)(1)(B) of the Internal Revenue Code of 1954, or as a dividend under Section 356(a)(2) of the Internal Revenue Code of 1954?

STATUTES INVOLVED

Internal Revenue Code of 1954:

"Sec. 356. Receipt of Additional Consideration.

"(a) Gain on Exchanges.—

"(1) Recognition of gain.—If—

"(A) section 354 * * * would apply to an exchange but for the fact that

"(B) the property received in the exchange consists not only of property permitted by section 354 * * * to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

"(2) Treatment as dividend.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized

under paragraph (1), shall be treated as gain from the exchange of property."

(26 U.S.C. 1952 ed., Supp. II, Sec. 356.)

Sections 302, 316, 354, 1001 and 1002 are printed in Appendix "B" below.

STATEMENT

The petitioner claims judgment for $210 tax and $5.55 interest thereon, assessed as a deficiency upon his individual federal income tax return for the calendar year 1954. The petitioner owned 450 shares of capital stock of The Washington Loan and Trust Company. In accordance with the terms of an Agreement of Consolidation, the petitioner in 1954 surrendered his 450 shares of Trust Company stock and received 56 shares of the capital stock of the consolidated bank (The Riggs National Bank of Washington, D. C.), a trustee's certificate for 2 8ths of a share, and $2,025 in cash. The cash payment received was reported by the petitioner as a capital gain under § 356(a)(1)(B) of the Internal Revenue Code. The Commissioner of Internal Revenue treated the cash as a taxable dividend and assessed a deficiency against the petitioner, which deficiency petitioner paid and filed a claim for refund and in due course filed a petition with the United States Court of Claims which petition was ordered to be dismissed in the Opinion below.

REASONS FOR GRANTING THIS WRIT

The decision below, if unreviewed, establishes as a precedent a pattern for application of Sec. 356 (a)(1)(B) which completely destroys and nullifies the whole effect and purpose of that often relevant provision.

If that provision does not apply to a case such as the present, to what does it apply? As the court below in its own earlier decision in the *Idaho Power Co.* case, 161 F. Supp. 807, so well put it:

> "If Congress meant merely to say that any boot money at all paid out of earnings should be a taxable dividend, it used a verbose and complicated way of saying it."

The instant case is typical of the many instances where relative values of stock involved in a reorganization cannot be expressed in terms of full shares or even in terms of reasonable fractions of shares. Under a decision such as that in the instant case, the money or boot would be fully taxed as a dividend, rather than as a capital gain, only because legitimate business reasons preclude the issuance of unreasonable fractional shares.

Section 354 of the Internal Revenue Code of 1954 specifies that in reorganizations, such as mergers or consolidations, gain or loss is not recognized if securities or stock are exchanged solely for securities or stock. Section 356(a)(1)(B) provides that if "*money*" is also received then a gain shall be recognized not in excess of the sum of such "*money*". Section 356(a)(2) further provides that if the payment has the effect of the distribution of a dividend, then such money is to be taxed as a dividend.

After the decision of this court in *Commissioner v. Estate of Bedford*, 325 U.S. 283, respondent developed a theory—by way of an extension of the *Bedford* decision—that if there are earnings and profits, i.e., unless the corporation is insolvent or has no earnings and profits, then *all* payments of money or boot become dividends and are taxable as such.

As indicated above, the court below rejected this theory in the *Idaho Power Co.* case and stated that dividend equivalence is determined "on the facts in each case".

However, the court below did not adhere to the facts as determined by its own Commissioner. The facts were that the competitive negotiations leading to merger and exchange of shares and money were at all times on a business basis and at arm's length; that The Riggs National Bank of Washington, D. C. —against the wishes of petitioner and other stockholders—made its exchange offer in terms of stock plus cash because The Riggs National Bank concluded that for its own purposes a stock-for-stock offer would create for The Riggs National Bank unreasonably small fractional shares in the local market; the offer which was made by The Riggs National Bank to petitioner was made in competition with a genuine competitive cash offer of an independent third banking corporation; that the $450,000 paid in trust prior to the consolidation by The Riggs National Bank for payment, in part, to petitioner came from the profit and loss account of The Riggs and that the assets of the consolidated bank did not include the $450,000 paid by The Riggs.

Yet the court characterized the transaction differently. It said

> "* * * the $450,000 was identified as funds earned and owned by the Trust Company. They were as completely identified as was the one-eyed man who was suspected of cheating in the early days' western poker game. One of the victims finally said, 'Now, I am not going to call any names, but if the man around this table who has been cheating doesn't stop, I am going to shoot out his other eye'."

All of the 42 Findings of Fact (see Appendix "A") of the Commissioner are exactly to the contrary, excepting No. 23, which states:

> "As of the close of business October 1, 1954, the Trust Company had earnings and profits of $909,671.49."

Legislative history clearly demonstrates that Congress was concerned with evasions and avoidance of tax. The roots of Section 356 extend back to the Revenue Act of 1918, but the specific provision was introduced by Section 203(d)(2) of the Revenue Act of 1924.

The House Committee in its Report on the Revenue Bill of 1924 (Rept. No. 179, 68th Cong. 1st Sess., pp. 14-15) explained the necessity for Sect. 203(d)(2) as follows:

> "(2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This subdivision provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable dividend shall be taxed as a dividend and not as a taxable gain.
>
> "The necessity for this provision may best be shown by an example: Corporation A has capital stock of $100,000, and earnings and profits accumulated since March 1, 1913, of $50,000. If it distributes the $50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.
>
> "On the other hand, corporation A may organize corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and $50,000 in

> cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the $50,000 distributed with the stock of corporation B would be taxed, not as a dividend, but as a capital gain, subject only to the 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain. *Here again this provision prevents evasions.*" (Emphasis supplied.)

In the same House Report is contained the separate "Views of Eleven Republicans" in support of the House Bill, and it is stated:

> "Changes Designed to Prevent the *Avoidance* of the Income Tax.
>
> "(2) The provisions of the reorganization section have been rewritten to prevent the use of the section to escape proper taxation * * * by distributing as capital gains what are in effect dividends out of earnings." (Id. pp. 36, 44.) (Emphasis supplied.)

The following results logically flow from the decision below:

Section 356(a)(1)(B) is eliminated from the Internal Revenue Code of 1954 excepting only if

> (i) The corporation is insolvent or had no earnings and profits, or
>
> (ii) The reorganization is a recapitalization (*Idaho Power Co.* case). Neither of these two exceptions has legislative sanction.

The question is vital to all corporations faced with reorganizations in the nature of a merger or consolidation. Unfortunately, the impact of the decision below is grossly inequitable.

A national corporation whose stock is listed on a national exchange or a corporation which has a large market for its stock is given a substantial competitive advantage. It can avoid dividend equivalence simply by issuing fractional shares.

By contrast, a local corporation whose stock is not listed on a national exchange or any corporation—listed or not on a local or national exchange—which has a thin market for its stock, for sound business reasons, may be unable to complicate its stock structure by the issuance of odd fractional shares. It is thus foreclosed from protecting its stockholders because of legitimate and practical business considerations.

A perfect illustration was before the Court below. The Riggs concluded that the market would not absorb the fractions which the Commissioner determined to be something more than 5 64ths of a share and something less than 3 32nds of a share. The conclusion was that for legitimate business reasons fractional shares could not be issued. Petitioner was denied a capital gain which would have been his undisputed right if fractional shares had been issued.

Thus the decision below penalizes the stockholders of the great number of local or unlisted corporations which for perfectly legitimate business reasons in perfectly legitimate reorganizations are not able to market commercially unattractive fractional shares.

In essence, the decision permits form rather than substance to determine the tax result to the benefit of the few and to the detriment of the many.

CONCLUSION

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted.

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APPENDIX "A"

IN THE UNITED STATES COURT OF CLAIMS

No. 93-57

(Decided June 3, 1959)

TENNEY ROSS v. THE UNITED STATES

Mr. Robert Holt Myers for the plaintiff. *Messrs. John H. Myers, Frederick M. Bradley, Paul F. Myers* and *Williams, Myers and Quiggle* were on the brief.

Mr. John A. Rees, with whom was *Mr. Assistant Attorney General Charles K. Rice*, for the defendant. *Messrs. James P. Garland* and *Lyle M. Turner* were on the brief.

OPINION

JONES, *Chief Judge*, delivered the opinion of the court:

Plaintiff sues for refund of income taxes paid on an amount which the taxing authorities treated as a dividend, and which he claims should have been treated as long-term capital gain.

In 1954 plaintiff owned 450 shares of capital stock in the Washington Loan and Trust Company of Washington, D. C., hereinafter referred to as the "Trust Company," a banking corporation organized under the laws of the District of Columbia. The Riggs National Bank of Washington, D. C., hereinafter referred to as the "Riggs Bank," is a national banking association organized under the banking laws of the United States.

In April of 1954 the president of the Trust Company and the president of Riggs Bank and their assistants began preliminary discussions about a possible consolidation. The negotiations were at all times carried out at arm's length and on a business basis. The president of the Trust Company requested the president of Riggs Bank to make an offer of exchange on a stock-for-stock basis,

and at all times the Riggs Bank officials knew that the Trust Company desired an exchange on that basis.

The representatives of the Riggs Bank found that a stock-for-stock offer would create unreasonably small fractional shares of stock, less than one-eighth of a share. The Riggs Bank representatives decided that their offer would be in terms of stock plus cash.

As a result of the preliminary negotiations, a study of the book values of the two banking institutions was made, and in May of 1954, the comptroller of the Riggs Bank prepared a "Suggested Exchange Offer" of one share of Riggs Bank stock for eight shares of Trust Company stock, plus $3 in cash for each Trust Company share. Apparently, no action was taken on that offer.

About three months later, the Equity Corporation of New York City offered to buy all the Trust Company stock for $51.50 a share.

Shortly thereafter negotiations between the Riggs Bank and the Trust Company were resumed. The book values of the two banks were recomputed as of the date of the Equity offer, and the adjusted book value of the Riggs Bank was determined to be $392.89 a share and that of the Trust Company to be $49.08 a share. Studies indicated that a 1 for 8 exchange ratio would produce an ownership benefit of .27 percent, which would be a $75,000 ownership advantage to the Riggs Bank shareholders in the $26,000,000 assets of the consolidated bank. That would mean that the Riggs Bank would be contributing 82.49 percent of the assets and receiving 82.76 percent of the stock ownership in the combined bank. The Riggs Bank decided to make an offer of one share of Riggs Bank stock for eight shares of Trust Company stock, plus a cash payment of $4.50 a share, or $52.83, as competitive with the offer of $51.50 made by the Equity Corporation. The second Riggs Bank offer was designed to be sufficiently higher than the Equity offer to discourage a counter-offer.

When the president of the Trust Company received the second Riggs Bank offer, he again requested that a stock-for-stock offer be made. He was told that a straight stock-for-stock exchange would result in 1.39311 shares for 8 shares. The Trust Company representatives tried to convert the offer into a stock-for-stock offer, but the fractional share would be something more than 5/64 of a share and something less than 3/32 of a share in the consolidated bank. The president of the Trust Company, unable to persuade the Riggs Bank to make such an offer, agreed to recommend to his board of directors that the second Riggs Bank offer be accepted.

The directors of the Riggs Bank and the directors of the Trust Company entered into an "Agreement of Consolidation" on the basis of the second Riggs Bank offer. This consolidation was effected pursuant to the provisions of section 3 of the National Banking Act of November 7, 1918, 40 Stat. 1043, as added by 44 Stat. 1224, and amended by 48 Stat. 162.[1]

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[1] "That any bank incorporated under the laws of any State, or any bank incorporated in the District of Columbia, may be consolidated with a national banking association located in the same State, county, city, town, or village under the charter of such national banking association on such terms and conditions as may be lawfully agreed upon by a majority of the board of directors of each association or bank proposing to consolidate, and which agreement shall be ratified and confirmed by the affirmative vote of the shareholders of each such association or bank owning at least two-thirds of its capital stock outstanding, • • •. Upon such a consolidation, • • •, the corporate existence of each of the constituent banks and national banking associations participating in such consolidation shall be merged into and continued in the consolidated national banking association and the consolidated association shall be deemed to be the same corporation as each of the constituent institutions. All the rights, franchises, and interests of each of such constituent banks and national banking associations in and to every species of property, real, personal, and mixed, and choses in action thereto belonging, shall be deemed to be transferred to and vested in such consolidated national banking association without any deed or other transfer; • • •"

The necessary ratification and confirmation by the shareholders of each of the banking institutions, and the approval of the Comptroller of the Currency were obtained. The consolidation became effective at the close of business on October 1, 1954.

As of the close of business on October 1, 1954, the Trust Company had earnings and profits of $909,671.49. Prior to the close of business on that same day, the Riggs Bank withdrew from its earnings and profits $450,000, which was set aside in a trust fund in the Riggs Bank trust department, to be used to pay the $4.50 per Trust Company share, as provided under the terms of the Agreement of Consolidation. The assets of the consolidated bank did not include the $450,000 withdrawn by the Riggs Bank, but did include all of the other assets of both banks.

Plaintiff exchanged his 450 shares of Trust Company stock for 56 shares of the consolidated bank and $2,025 in cash. It is plaintiff's position that the $2,025 is capital gain within the purview of § 356(a)(1)(B) of the Internal Revenue Code of 1954.[2]

The Government says that the cash received by plaintiff is either an ordinary dividend within the meaning of

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[2] What took place was not a sale, but was a consolidation with an exchange of stock and payment of cash. The consolidation was under the authority of section 3 of the National Banking Act, *supra*, and a consolidation pursuant thereto is not a sale. *United States* v. *Seattle Bank*, 321 U.S. 583 (1944). Section 368 of the 1954 Code includes a consolidation within the definition of a "reorganization", and a reorganization such as the one in this case receives the special tax treatment provided for in § 356(a)(1) or (2).

§ 316 of the 1954 Code, or "has the effect of the distribution of a dividend" within the meaning of § 356(a)(2).[3]

The cash received by plaintiff was not physically paid to him by the Trust Company out of its earnings and profits, and, in a technical sense, cannot be an ordinary dividend as defined in § 316.

The issue here is a close one. There is no question of the good faith of both parties to the consolidation. The question here, however, is the wording and interpretation of the applicable statute. The ultimate question finally narrows down to whether the payment had the effect of a distribution of a dividend under § 356(a)(2).

The answer to that question depends on all the facts and circumstances surrounding the distribution. *Idaho Power Company* v. *United States*, No. 208-55, decided May 7, 1958, 161 F. Supp. 807, cert. den. 358 U.S. 832; *Northup* v. *United States*, 240 F. 2d 304 (2d Cir. 1957); *Smith* v.

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[3] "§ 356. Receipt of additional consideration.

"(a) Gain on exchanges.

"(1) Recognition of gain.

"If—

"(A) section 354 • • • would apply to an exchange but for the fact that

"(B) the property received in the exchange consists not only of property permitted by section 354 • • • to be received without the recognition of gain but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

"(2) Treatment as dividend.

"If an exchange is described in paragraph (1) *but has the effect of the distribution of a dividend*, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property." [26 U.S.C., 1952 ed., Supp. II, § 356.] [Emphasis supplied.]

United States, 131 C. Cls. 748 (1955); *Commissioner* v. *Snite*, 177 F. 2d 819 (7th Cir. 1949); *Stein* v. *United States*, 104 C. Cls. 446 (1945); *Rheinstrom* v. *Commr.*, 125 F. 2d 790 (6th Cir. 1942), and cases cited therein.

The problem of dividend equivalence usually arises in reorganization cases under § 356 (§ 112(c)(2) of the Internal Revenue Code of 1939) and in redemption cases under § 302 (§ 115(g) of the 1939 Code). The phrase "has the effect of the distribution of a dividend" in § 356 and its predecessor is in *pari materia* with the phrase "essentially equivalent to a dividend" as used in § 302 and its predecessor. *Hawkinson* v. *Commissioner*, 235 F. 2d 747 (2d Cir. 1956); *Kirschenbaum* v. *Commissioner*, 155 F. 2d 23 (2d Cir. 1946), cert. den. 329 U.S. 726.

Plaintiff says that the indicia of dividend equivalence applied by the courts in the general area of redemptions or cancellations are not applicable to his case. Different facts are considered depending upon the nature of the transaction from which the distribution arises, but the test remains the same, that of looking to all the facts and circumstances surrounding the distribution to appraise the consequences of the transaction.

Plaintiff urges vigorously that the Government's position in this case calls for a return to the automatic dividend equivalence theory, i.e., that whenever there is a distribution of "boot" money in connection with an exchange of stock or securities, and there are earnings and profits, the "boot" money is automatically a distribution of a dividend. *Commissioner* v. *Estate of Bedford*, 325 U.S. 283 (1945), has frequently been relied upon as authority for the automatic dividend equivalence theory. In *Idaho Power, supra*, this court, after a careful consideration of the *Bedford* case, held that it is consistent with the rule that the question of dividend equivalency is a question of fact in each case.

We have examined all the facts and circumstances of the instant case, and we cannot escape the conclusion that

the payment had the effect of the distribution of a dividend.

It makes no difference whether the $450,000 was distributed out of the earnings and profits of the Trust Company or out of such funds of the Riggs Bank set aside before consolidation. *Commissioner v. Owens*, 69 F. 2d 697 (5th Cir. 1934); *Woodward v. Commissioner*, 23 B.T.A. 1259 (1931). The net result was the same. If a stock-for-stock exchange could have been worked out without long-drawn-out fractions, undoubtedly there would have been a simple exchange of shares. If the distribution had been out of the funds of the Trust Company, that company would have brought into the consolidated bank $450,000 less than it actually brought in. Since it was physically paid out of set-aside funds of the Riggs Bank, that institution brought into the consolidated bank $450,000 less than it would have contributed had the Trust Company paid out the funds before consolidation. Whichever method was used, the net assets of the consolidated bank would have been the same. The more circuitous route was taken. The result was the same. It was merely the mechanics that were different.

Because of the mechanics employed to effect the payment of the money to the Trust Company shareholders, the money was not physically paid out of earnings and profits of the Trust Company but it was in reality funds earned and owned by the Trust Company. Had the Riggs Bank not withdrawn the $450,000 prior to consolidation, it would have been contributing 84.09 percent of the assets of the consolidated bank, rather than the 82.49 percent which it did contribute. The $450,000 distributed to the shareholders of the Trust Company represented the $75,000 imbalance of .27 percent in favor of the Riggs Bank shareholders and $375,000, i.e., .75 percent of the $50,000,000 deposits in the Trust Company, part of the "swing-in" value of certain non-book assets which the parties had agreed should be reflected in the exchange offer. Thus

the $450,000 was identified as funds earned and owned by the Trust Company. They were as completely identified as was the one-eyed man who was suspected of cheating in the early days' western poker game. One of the victims finally said, "Now, I am not going to call any names, but if the man around this table who has been cheating doesn't stop, I am going to shoot out his other eye."

So it follows that regardless of who physically paid out the money, and regardless of whose name is placed on those earnings, the effect is the same as if the Trust Company had made a distribution out of funds specifically labeled "Trust Company earnings and profits."

The question is whether the declaration of a dividend by the Trust Company would have accomplished the same result as the distribution of the $450,000 by the Riggs Bank. *Smith* v. *United States, supra; Northup* v. *United States, supra.* In *Smith,* we found that the distribution of a dividend would not have accomplished the purpose of the corporation, which was the acquisition of stock to be optioned to and later purchased by a key employee, and therefore the distribution was not essentially equivalent to a dividend. Plaintiff says that the declaration of a dividend here would not have accomplished the purpose of effecting a consolidation, but neither would the payment by the Riggs Bank of the $450,000 have accomplished a consolidation, but it accomplished a step leading to the consolidation. The declaration of a dividend by the Trust Company would also have accomplished that same step, i.e., the step of bringing the stock ownership into line with the assets contributed.

Plaintiff argues vigorously that the results of this transaction show that this distribution does not have the effect of a dividend within the test set out in the *Idaho Power* case, *supra,* at page 5 of the slip opinion:

> An important indicium of equivalence of a payment to a dividend is present if, after the exchange of stock and the payment, the shareholder still has *the same*

> *or substantially the same interest in the corporation after the payment that he had before.* [The ordinary dividend received by a shareholder does not disturb his interest in the corporation at all. He has the right, in the future, to the same fixed rate of dividend on his preferred stock, or the same share of profits, on his common stock, as he had before the dividend was paid. * * * [Emphasis added.]

Plaintiff says that after the consolidation his status was "drastically" changed: that prior to the consolidation he owned 450 shares in the Trust Company and after the consolidation he had some 56 shares in a different corporation; that before he had an interest of 4.5/100 of 1 percent in the Trust Company and after he had an interest of 8/100 of 1 percent in the consolidated bank. However, these changes are such as are inherent in any statutory consolidation. Plaintiff has the same right to receive dividends in the future and the same right to a share of the assets upon dissolution of the consolidated bank as he would have had, if the Trust Company had declared a dividend of $4.50 a share.

We have appraised the results of the transaction here in question, and we conclude that the payment had the effect of the distribution of a dividend.

The petition will be dismissed.

It is so ordered.

BRYAN, *District Judge*, sitting by designation; LARAMORE, *Judge*; MADDEN, *Judge*, and WHITAKER, *Judge* concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Richard H. Akers, and the briefs and argument of counsel, makes findings of fact as follows:

1. The plaintiff is a citizen of the United States and a resident of the District of Columbia. He kept his books

on a cash basis. On February 8, 1955, he filed his individual Federal income tax return for the calendar year 1954 disclosing a total tax liability of $706.68 which was timely paid.

2. In 1954 the plaintiff owned 450 shares of capital stock in the Washington Loan and Trust Company of Washington, D. C.

3. The Riggs National Bank of Washington, D. C. (hereinafter referred to as the "Riggs Bank"), on August 24, 1954, and at all other times herein material was a national banking association organized under the banking laws of the United States. It had capital stock outstanding in the amount of $6,000,000, consisting of 60,000 shares of common stock having a par value of $100 per share.

4. The Washington Loan and Trust Company (hereinafter referred to as the "Trust Company") on August 24, 1954, and at all other times herein material was a banking corporation organized under the laws of the United States relating to the District of Columbia. It had capital stock outstanding in the amount of $1,000,000, consisting of 100,000 shares of common stock having a par value of $10 per share.

5. The Riggs Bank and the Trust Company were located in the District of Columbia.

6. In April 1954, the president of the Trust Company and the President of the Riggs Bank and their immediate executive assistants entered into private preliminary discussions respecting possible consolidation. These discussions and negotiations between the representatives of the Riggs Bank and the Trust Company, which resulted in the consolidation, were carried out at arm's length and on a business basis. It was agreed during these discussions that:

(a) Consolidation had advantages to the community, shareholders, depositors and employees.

(b) A study of the book values of the two institutions for the purpose of comparison was to be undertaken.

(c) No final comparison of book values could be made until a surcharge suit pending in the court against the Trust Company and a deceased co-trustee in the amount of $489,222.12 had been brought to a conclusion.

7. The president of the Trust Company requested the president of the Riggs Bank to make his offer of exchange on a stock for stock basis and the negotiators representing the Riggs Bank were at all times aware that the officials of the Trust Company desired that the exchange be made on that basis. However, the representatives of the Riggs Bank decided that the offer could not be expressed in terms of reasonable fractional shares of stock and determined that their offer should be in terms of stock plus cash which, as will hereinafter appear, was the manner in which the offer was ultimately made and accepted.

8. On May 1, 1954, the comptroller of the Riggs Bank completed six studies of comparative book values of the Riggs Bank and the Trust Company as of April 30, 1954, taking into consideration (1) the book values without reserve for bad debts; (2) book values with reserve for bad debts; (3) book values adjusted for taxes without reserve for bad debts; (4) book values adjusted for taxes with reserve for bad debts; (5) book values adjusted for taxes, possible surcharge liability, hidden assets, but without reserve for bad debts; and (6) book values adjusted for taxes, possible surcharge liability, hidden assets and reserve for bad debts, with the following results:

(a) The book value of the Riggs Bank stock compared to the Trust Company stock under the circumstances (1) to (6), inclusive, just described were, in order, as follows: $359.16 to $50.33; $370.54 to $51.95; $359.16 to $48.30; $370.54 to $49.92; $359.16 to $47.14; and $370.54 to $48.76.

(b) A comparison of the book values of 1 share of the Riggs Bank stock to 7 shares of the Trust Company stock without reserve for bad debts produced a dollar advantage to the Riggs Bank shareholder of $6.85, i. e., $359.16 to $352.31.

(c) A comparison of the book values of 1 share of the Riggs Bank stock to 7 shares of the Trust Company stock with reserve for bad debts, produced an advantage to the Riggs Bank shareholder of $6.89, i. e., $370.54 to $363.65.

(d) A comparison of the book values of 1 share of the Riggs Bank stock to 7½ shares of the Trust Company stock, without reserve for bad debts but adjusted for taxes, produced a disadvantage to the Riggs Bank shareholder of $3.09, i e., $359.16 to $362.25.

(e) A comparison of the book values of 1 share of the Riggs Bank stock to 7½ shares of the Trust Company stock, with reserve for bad debts and adjusted for taxes, produced a disadvantage to the Riggs Bank shareholder of $3.86, i. e., $370.54 to $374.40.

(f) A comparison of the book values of 1 share of the Riggs Bank stock to 7½ shares of the Trust Company stock, without reserve for bad debts but with adjustment for taxes, possible surcharge liability and hidden assets, produced an advantage to the Riggs Bank shareholder of $5.61, i. e., $359.16 to $353.55.

(g) A comparison of the book values of 1 share of the Riggs Bank stock to 7½ shares of the Trust Company stock, with reserve for bad debts, adjustment for taxes, possible surcharge liability and hidden assets produced an advantage to the Riggs Bank shareholder of $4.84, i. e., $370.54 to $365.70.

9. The representatives of the Riggs Bank at this time determined that a stock for stock offer had three substantive disadvantages to the Riggs Bank:

(a) A study at the time of a stock dividend on the Riggs Bank stock earlier in 1954 demonstrated that fractions less than one-eighth of a share could not be absorbed by the local securities market.

(b) Bank capital is invariably expressed in even figures and odd fractional shares would produce an odd capital structure.

(c) In the event additional shares were authorized to even out a possible odd capital structure, but were not issued, then the capital structure would be further complicated by the preemptive rights of the shareholders in the authorized but unissued capital stock.

10. On May 4, 1954, the comptroller of the Riggs Bank prepared a "Suggested Exchange Offer" in which he used an exchange ratio of one share of Riggs Bank stock to 8 shares of Trust Company stock and $24 cash, i. e., $3 per share. The Suggested Exchange Offer assumed an adjusted book value as of April 30, 1954 (including the potential surcharge liability), of $48 for the Trust Company stock and $360 for the Riggs Bank stock and assumed a capital structure of 72,500 shares of $100 par value.

11. In late June, 1954, the Trust Company and the representatives of its deceased co-trustee agreed for the purpose of settlement to compromise the surcharge suit for $50,000, which compromise became public knowledge by entry of an order of court on August 6, 1954.

12. On August 13, 1954, a week after the entry of the order of court, the Equity Corporation of New York City by letter offered to buy Trust Company stock from the shareholders of the Trust Company for $51.50 per share.

13. The president of the Trust Company and the president of the Riggs Bank were vacationing when they learned of the above offer but, upon its publication, immediately resumed negotiations and instructed their subordinates to recompute the book values of the Trust Company and the Riggs Bank as of August 13, 1954, i. e., the date of the Equity Corporation offer.

14. The studies and negotiations produced the following results:

(a) The adjusted book value of the Riggs Bank stock was determined to be $392.89 per share and the

adjusted book value of the Trust Company stock was determined to be $49.08 per share.

(b) It was determined that the adjusted basis of the combined assets of the two banks upon consolidation would be in the following approximate relationship:

	Percent
Riggs Bank assets	82.49
Trust Company assets	17.51
Consolidated bank assets	100.00

(c) It was determined that a 1 for 8 exchange of stock of the Trust Company upon consolidation would produce a percentage of stock ownership upon consolidation as follows:

	Percent
Riggs Bank shareholders	82.76
Trust Company shareholders	17.24
	100.00

(d) A comparison of the percentage of assets to be contributed to the consolidated bank with the percentage of stock ownership that would follow a 1 to 8 exchange, indicated an ownership benefit to the Riggs Bank shareholder of .27% which, converted into dollars, was a $75,000 ownership advantage to the Riggs Bank shareholders in the $26,000,000 assets of the combined bank.

15. The negotiators agreed that in addition to adjusted book values, non-book assets such as the deposits and trust department business had a value (denominated by the Comptroller of the Treasury as the "swing-in" value) because they produce banking income. It was agreed by the negotiators that the exchange offer of the Riggs Bank should reflect the value of these assets. A study of this item produced the following:

(a) As of August 13, 1954, the date of the Equity Corporation offer, there were deposits in excess of $50,000,000 in the Trust Company.

(b) Representatives of the Riggs Bank discussed with the Comptroller of the Currency the value normally placed upon deposits in consolidations or mergers and were advised that in the previous year (1953) the value placed on such deposits, in the case of the consolidation or merger of national banks, ranged between one-half of one per cent to one per cent.

16. The representatives of the Riggs Bank prepared recommendations for an exchange offer to be submitted for the consideration of the executive committee of the Riggs Bank. The steps taken were as follows:

(a) They took the adjusted book value of the Trust Company stock at $49.08; which amount had been computed as shown in finding 14.

(b) They reduced this value by $0.75 to reflect the per share loss to the Trust Company stock resulting from the excess of .27% of the assets contributed by the Trust Company over the percentage of stock allocated to the Trust Company shareholders.

(c) The net amount was a value of $48.33 per share for the Trust Company stock.

(d) The representatives of the Riggs Bank selected a maximum "swing-in" value of $375,000 for the $50,000,000 deposits of the Trust Company and computed the same to be .75% of deposits, that is, $3.75 per share of Trust Company stock.

(e) They inquired of the Comptroller of the Currency the propriety of valuing the deposits at .75% and were advised that such a value would meet with the approval of the Office of the Comptroller.

(f) They then prepared a study which indicated that an offer of exchange of 8 shares of Trust Company stock for 1 share of stock in the consolidated bank would have the following equivalent value to the equity Corporation offer of $51.50 per share:

8 shares for 1 plus $3.00 per share exchanged = $51.33
8 shares for 1 plus $3.50 per share exchanged = $51.83
8 shares for 1 plus $4.00 per share exchanged = $52.33
8 shares for 1 plus $4.50 per share exchanged = $52.83

The executive committee of the Riggs Bank elected the offer incorporating the exchange of one share for 8 plus $36, that is, $4.50 per share, as competitive with the offer of the Equity Corporation and recommended the same to the directors of the Riggs Bank. The directors of the Riggs Bank accepted the recommendation of the executive committee and authorized the president of the Riggs Bank to convey that offer to the president of the Trust Company. That offer was designed to be competitive with the outstanding offer of the Equity Corporation of $51.50 per share. That offer was also made by the representatives of the Riggs Bank after these representatives were satisfied that it could be justified to the stockholders of the Riggs Bank and to the Comptroller of the Currency. It was felt by these representatives of the Riggs Bank that it was sufficiently higher than the offer of the Equity Corporation so as to discourage a counteroffer by the Equity Corporation. All parties to the transaction were advised that the cash to be paid to the stockholders of the Trust Company in connection with the offer was to be paid out of the earnings and profits of the Riggs Bank and it was paid from that source.

17. Upon receipt of that offer, the president of the Trust Company again requested that an offer be in terms of stock for stock but he was advised that a pure stock for stock exchange on this basis would result in an exchange of 1.09311 shares for 8 shares.

Representatives of the Trust Company tried for a day to convert the offer of one share for 8 shares and $36 cash into a stock for stock offer but the fraction, which represented something more than 5 64ths of a share and something less than 3 32nds of a share, was such that they were unable to persuade the representatives of the Riggs Bank to make a stock for stock offer.

When the president of the Trust Company finally recognized that a stock for stock offer would not be forthcoming

from the Riggs Bank, he agreed to recommend to the board of directors of the Trust Company that they accept the offer.

The representatives of the Trust Company at all times proposed and requested an exchange of stock for stock without cash but the representatives of the Riggs Bank concluded that the price they had to pay to meet the competitive offer of the Equity Corporation could not be expressed in terms of a stock for stock offer and that the inclusion of cash as an element of exchange was necessary to meet the competitive offer of the Equity Corporation. As previously indicated, the representatives of the Riggs Bank were responsible for the inclusion of cash as a part of the offer.

18. On August 24, 1954, the directors of the Trust Company and the directors of the Riggs Bank entered into an "Agreement of Consolidation" which outlined the terms under which the Trust Company and the Riggs Bank were to consolidate under the charter of the Riggs Bank pursuant to the provisions of Title 12, U. S. C., Sec. 34a, "An Act to provide for the consolidation of National Banking Associations", approved November 7, 1918, as amended.

That agreement contained the offer of the Riggs Bank to consolidate with the Trust Company on the basis of an exchange of one share of stock in the consolidated bank for 8 shares of Trust Company stock plus $36, that is, $4.50 per share.

19. The agreement of consolidation included in substance the following provisions:

(a) That the consolidation was to become effective upon ratification and confirmation by the shareholders of each bank and upon the issuance by the Comptroller of the Currency of a "Certificate of Consolidation".

(b) That the Trust Company was to contribute assets having a value of at least $4,600,000 in excess of

outstanding liabilities and that the Riggs Bank was to contribute assets having a value of at least $21,400,000 in excess of its liabilities.

(c) That upon consolidation the resulting bank was to have capital stock outstanding in the amount of $7,250,000, consisting of 72,500 shares of common stock having a par value of $100 per share, surplus amounting to $15,000,000, and undivided profits of not less than $3,750,000, that is, total capital stock, surplus, and undivided profits of not less than $26,000,000.

(d) That the shareholders of the Trust Company were to surrender the stock of the Trust Company in exchange for the 12,500 shares of stock in the consolidated bank and $450,000 in cash. The exchange was to be on the basis of one share of stock of the consolidated bank and $36 for each eight shares of stock of the Trust Company surrendered. No fractional shares were to be issued by the consolidated bank but the shareholders of the Trust Company who were entitled to fractional shares would receive a "Trustees Certificate of Participation" evidencing the right to such fractional shares in denominations of one-eighth to seven-eighths, inclusive. The shareholders of the Trust Company could sell or otherwise dispose of their Trustees Certificates of Participation or round out whole shares by purchase or otherwise.

(e) That the participation of the shareholders of the Riggs Bank in the consolidated bank was to be on a share for share basis and, since the consolidation was to be under the charter and title of "The Riggs National Bank of Washington, D. C.", new certificates were not to be issued for the Riggs Bank stock outstanding at the time of the consolidation.

(f) That the $450,000 to be paid the shareholders of the Trust Company was to be paid from a trust fund to be established by the Riggs Bank in its trust department prior to the consolidation.

20. On September 14, 1954, the board of directors of the Riggs Bank by resolution directed that, upon ratification of the Agreement of Consolidation by the shareholders

of the Trust Company and the Riggs Bank, the sum of $450,000 be transferred from the assets of the Riggs Bank to the trust department of the Riggs Bank prior to the consolidation.

21. On September 29, 1954, the shareholders of each bank ratified the Agreement of Consolidation to become effective at the close of business October 1, 1954, by the issuance by the Comptroller of the Currency of a certificate approving the consolidation. Each shareholder of each bank was entitled to one vote per share of capital stock owned by him and at the meeting of shareholders called by each bank to ratify and confirm the Agreement of Consolidation on September 29, 1954, the votes cast by the shareholders of each bank were as follows:

	Trust Company	*Riggs Bank*
Shares of capital stock outstanding	100,000	60,000
Votes in favor	98,705	57,212
Percentage in favor	98.71	95.55
Votes against	zero	zero

22. On October 1, 1954, the Comptroller of the Currency approved the consolidation of the Riggs Bank and the Trust Company as of the close of business 2 p. m. Friday, October 1, 1954.

23. As of the close of business October 1, 1954, the Trust Company had earnings and profits of $909,671.49.

24. The Comptroller of the Riggs Bank, prior to the close of business October 1, 1954, drew a cashier's check in the amount of $450,000 payable to the trust department of the Riggs Bank. The check was delivered by the comptroller of the Riggs Bank to the senior trust officer of the Riggs Bank, who deposited it that day in the American Security and Trust Company to the credit of the trust department of Riggs Bank. Prior to the close of business October 1, 1954, the $450,000 cashier's check was debited to the profits and loss account on the general ledger of the Riggs Bank.

25. The $450,000 to be paid the shareholders of the Trust Company ($4.50 per share) under the terms of the Agreement of Consolidation represents a total of the $75,000 imbalance of .27 per cent in favor of the Riggs Bank shareholders and $375,000, i. e., .75 per cent of the $50,000,000 deposits in the Trust Company on August 13, 1954.

26. The Riggs Bank on August 30, 1954, advised its shareholders by letter that—

> • • • After providing for the cash payment • • • in the amount of $450,000, Riggs will contribute • • • 82.49% of the total value of acceptable assets • • • being contributed by both consolidating banks; • • •

and

> • • • a shareholder of the Trust Company owning 8 shares of its stock would receive 1 share of stock of the Consolidated Bank having a value as of August 13, 1954, of $386.64. In addition, he would receive $36 in cash (being 8 times $4.50) making a total value of $422.64, which, when divided by 8 equals a value as of August 13, 1954 equivalent to $52.83.

27. The Trust Company on August 30, 1954, advised its shareholders that—

> • • • The Riggs National Bank would contribute 82.49% and The Washington Loan and Trust Company 17.51% [of the net contribution of adjusted book value net worth of $28,031,272.00 to the Consolidated Bank].

28. Each of the letters to the shareholders contained the following statement on the printed "Statements of Assets and Liabilities as of August 13, 1954"—

> Allowance has been made • • • for the $450,000.00 to be placed in trust immediately prior to the consolidation by The Riggs National Bank for payment to The

Washington Loan and Trust Company shareholders of $4.50 per share as provided under the terms of the Agreement of Consolidation.

29. If the $450,000 had not been excluded from the net contribution of the Riggs Bank or if the $450,000 had been included among such assets, the contribution of the Riggs Bank would have been 84.09 per cent of the assets of the consolidated bank rather than 82.49 per cent. The contribution of the shareholders of the Trust Company to such assets would have been 15.91 per cent rather than 17.51 per cent.

30. The letters to the shareholders dated August 30, 1954, were reviewed by the office of the Comptroller of the Treasury prior to the date they were released. The question of the computation of the contribution of the shareholders of the two banks was discussed in detail with the Comptroller prior to the issuance of his letter of approval dated September 1, 1954.

31. As of the close of business at 2 p. m. Friday, October 1, 1954, the profit and loss account of the Riggs Bank showed a balance of $2,856,209.72.

32. In the Report of Condition of the Riggs Bank at the close of business October 1, 1954, made to the Comptroller of the Currency (form 2130A) in capital accounts under undivided profits is the sum of $2,923,420.57 which is the combined total of the net profit and loss of $2,856,209.72 and of net earnings of $67,210.85.

33. In the Report of Condition of the Trust Company at the close of business October 1, 1954, made to the Comptroller of the Currency (form 2130A) in capital accounts under undivided profits is the sum of $909,671.49.

34. At the organization meeting of the consolidated bank held at 2:15 p. m., October 1, 1954, after the close of business of the Riggs Bank and of the Trust Company, the board of directors caused the sum of $250,000 to be trans-

ferred from the profit and loss (undivided profits) account of the consolidated bank to the capital account of the consolidated bank to make the capital account of the consolidated bank equal $7,250,000, in accordance with the Agreement of Consolidation.

35. In the Report of Condition of the consolidated bank after consolidation as of October 1, 1954, made to the Comptroller of the Currency (form 2130A) in capital accounts under undivided profits is the sum of $3,583,092.06. This sum is the total of undivided profits of the Riggs Bank prior to consolidation in the amount of $2,923,420.57 and undivided profits of the Trust Company prior to consolidation in the amount of $909,671.49, less the $250,000 transferred at the organization meeting of the consolidated bank from the undivided profits account to the capital account.

36. The assets of the consolidated bank did not include the $450,000 paid by the Riggs Bank and credited to the trust department of the Riggs Bank prior to consolidation.

37. The $450,000 paid by the Riggs Bank to the trust department of the Riggs Bank prior to the consolidation came from the profit and loss account of the Riggs Bank.

38. The plaintiff surrendered his 450 shares of Trust Company stock and received 56 shares of the capital stock of the consolidated bank, a trustees' certificate of participation evidencing the plaintiff's right to receive 2/8ths share of the consolidated bank's stock, and $2,025 in cash.

39. The value of the shares received was in excess of the basis of stock given in exchange and the plaintiff reported the $2,025 cash as a long-term capital gain in his 1954 individual income tax return.

40. In letters dated September 10, 1954, and May 17, 1955, in response to requests from counsel for plaintiff for a ruling as to the taxability of the cash received by the shareholders of the Trust Company, the Commissioner of

Internal Revenue ruled that the cash received had the effect of a distribution of a dividend.

41. On September 24, 1955, the Commissioner assessed a deficiency against the plaintiff in the amount of $210 by excluding the long-term capital gain and including the cash of $2,025 as a taxable dividend. On December 21, 1955, the plaintiff paid under protest the deficiency of $210 with interest in the amount of $5.55.

42. On August 20, 1956, the plaintiff filed a claim for refund for the year 1954 for an overpayment of $210 of income tax and $5.55 interest, alleging that the cash received constituted a capital gain within the purview of Section 356 (a) (1) (B) of the Internal Revenue Code of 1954. By registered letter dated January 9, 1957, the District Director of Internal Revenue at Baltimore, Maryland, gave notice of the disallowance of that claim for refund.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is therefore dismissed.

APPENDIX "B"

Internal Revenue Code of 1954 (68 A. Stat.)

SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317 (b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTIONS TREATED AS EXCHANGES.—

(1) REDEMPTIONS NOT EQUIVALENT TO DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) SUBSTANTIALLY DISPROPORTIONATE REDEMPTION OF STOCK.—

(A) IN GENERAL.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) LIMITATION.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) DEFINITIONS.—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) SERIES OF REDEMPTIONS.—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) TERMINATION OF SHAREHOLDER'S INTEREST.—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) * * * * *

(5) * * * * *

(C) * * * * *

SEC. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent

thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

(b) * * * * *

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.—

(1) IN GENERAL.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(2) * * * * *

(3) CROSS REFERENCE.—

For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) * * * * *

* * * * * * * * * * *

(b) * * * * *

SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) COMPUTATION OF GAIN OR LOSS.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) AMOUNT REALIZED.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser, and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164 (d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) RECOGNITION OF GAIN OR LOSS.—In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this subtitle shall be determined under section 1002.

(d) INSTALLMENT SALES.—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 1002. RECOGNITION OF GAIN OR LOSS.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 315

TENNEY ROSS, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion, findings of fact, and conclusion of law of the Court of Claims (Pet. 1a-23a) are not yet officially reported.

JURISDICTION

The order of the Court of Claims dismissing the taxpayer's petition was entered on June 3, 1959 (Pet. 1a, 9a). The taxpayer's petition for a writ of certiorari was filed on August 14, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

The consolidation of the Washington Loan and Trust Company with the Riggs Bank was effected by an exchange of stock for stock, together with a pro rata distribution of cash to the stockholders of the Trust Company which was exceeded by the accumulated earnings and profits of the Trust Company. The question presented is whether the Court of Claims erred in holding that, under the circumstances attending this transaction, the distribution of cash to the stockholders of the Trust Company, including the taxpayer herein, had the effect of the distribution of a dividend under Section 356(a)(2) of the Internal Revenue Code of 1954.

STATUTES INVOLVED

Internal Revenue Code of 1954:

> SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.
>
> (a) *General Rule.*—
>
> (1) *In general.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.
>
> * * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 354)

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) *Gain on Exchanges.*—

(1) *Recognition of gain.*—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) *Treatment as dividend.*—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 356)

STATEMENT

The material facts, as found by the Court of Claims (Pet. 9a-23a), may be summarized as follows:

At the beginning of 1954, the Riggs National Bank of Washington, D. C. (hereafter referred to as the Riggs Bank), was a national banking association organized under the banking laws of the United States with capital stock outstanding in the amount of $6,000,000. The Washington Loan and Trust Company of Washington, D. C. (hereafter referred to as the Trust Company), was a banking corporation organized under the laws of the District of Columbia with capital stock outstanding in the amount of $1,000,000. The taxpayer owned 450 shares of capital stock in the Trust Company (Pet. 10a).

In April 1954, negotiations were commenced with a view to consolidation of the Trust Company with the Riggs Bank. The representatives of the Trust Company desired a consolidation which would involve only an exchange of stock for stock. The representatives of the Riggs Bank, however, were unwilling to make such an offer, believing that a straight stock-for-stock exchange would create unreasonably small fractional shares of Riggs Bank stock. Hence, they proposed to acquire all of the stock of the Trust Company in exchange for Riggs Bank stock plus cash [1] (Pet. 10a-11a).

---

[1] The practical objective and effect of the transactions in question was the absorption of the Trust Company into the Riggs Bank, with stock of the latter being issued (together with cash) in exchange for stock of the former. Strictly speaking, however, in terms of the statutory provision governing the consolidation (Act of November 7, 1918, ch. 209, Sec. 3, 40 Stat. 1043, as amended, 12 U.S.C. 34a) the result of the transactions was a consolidated corporate entity

After some months of negotiation and an intervening offer of a third corporation to buy all of the Trust Company stock for cash, the Riggs Bank made a final offer to issue one share of Riggs Bank stock in exchange for eight shares of Trust Company stock, plus a cash payment to Trust Company stockholders of $4.50 for each share of their stock surrendered. This offer reflected the relative percentages of assets which the Riggs Bank and the Trust Company would contribute to the new consolidated bank. With some reluctance the Trust Company, which still desired a straight stock-for-stock exchange, accepted the offer. It was embodied in an Agreement of Consolidation, effective at the close of business on October 1, 1954. The approval of the Comptroller of the Currency was obtained for this consolidation, which was effected under the provisions of the Act of November 7, 1918, ch. 209, Sec. 3, 40 Stat. 1043, as amended, 12 U.S.C. 34a (referred to in the opinion of the Court of Claims as Section 3 of the National Banking Act of November 7, 1918, as amended) (Pet. 11a-19a).

As of the close of business on the date of consolidation, October 1, 1954, the Trust Company had earnings and profits of $909,671.49. Prior to the

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in which both the Trust Company and the Riggs Bank were deemed to be surviving components, but which continued to be known as the Riggs Bank. Thus, the so-called Riggs Bank stock which the stockholders of the Trust Company received for their stock (together with cash), was actually stock of the new consolidated bank, reflecting the consolidated assets of both predecessors.

close of business on the same day, the Riggs Bank set aside a trust fund of $450,000, debited to its profits and loss account, to be used to pay the $4.50 in cash for each Trust Company share. The assets of the consolidated bank, which exceeded $26,000,000, did not include the $450,000 set aside by the Riggs Bank for distribution to Trust Company stockholders. Riggs Bank contributed in excess of eighty per cent of the total assets to the new consolidated bank and received a corresponding percentage of stock ownership therein. At the close of business on the date of consolidation, the profit and loss account of the Riggs Bank showed a balance of $2,856,209.72 (Pet. 19a-22a).

The taxpayer, in exchange for his 450 shares of Trust Company stock, received 56 shares of the capital stock of the consolidated bank, $2,025 in cash, and a trustee's certification evidencing his right to receive 2/8ths of a share of the consolidated bank's stock. The value of the shares received by the taxpayer was in excess of the basis of stock given in the exchange and the taxpayer reported $2,025 cash as a long-term capital gain in his 1954 return. Upon audit of the return the Commissioner determined that the cash received by the taxpayer had the effect of a dividend distribution and hence included the full amount in ordinary income, at the same time time excluding the long-term capital gain reported. The taxpayer paid the resulting deficiency and accumulated interest under protest and, after a timely claim for refund was disallowed, brought the in-

stant suit for refund in the Court of Claims (Pet. 22a-23a).

The Court of Claims concluded as a matter of law, upon the basis of its findings of fact, that the taxpayer was not entitled to recover and hence that his petition should be dismissed (Pet. 23a).

ARGUMENT

1. The sole issue presented to the Court of Claims was whether a distribution of cash in an otherwise tax-free reorganization of banking corporations resulted in long-term capital gain to the recipient stockholders, as the taxpayer contended, or had the effect of the distribution of a dividend, as the Government asserted. The Court of Claims sustained the Government's position. In assailing that decision here, the taxpayer does not claim a conflict of decisions; rather, he takes issue with the court's analysis of the facts and circumstances underlying the cash distribution in question, and with its conclusion that the distribution had precisely the same effect as if the Trust Company had distributed its available earnings and profits to its stockholders in an ordinary dividend. We submit that no appropriate ground for certiorari is demonstrated by the taxpayer or emerges from the Court of Claims' decision.

2. Section 354(a)(1) of the Internal Revenue Code of 1954, *supra*, p. 2 (like its predecessor, Section 112(b)(3) of the 1939 Code), provides that no gain or loss shall be recognized upon an exchange of stock for stock between parties to a corporate reorganization. Section 356(a)(1) of the 1954 Code,

supra, p. 3 (like its predecessor, Section 112(c)(1) of the 1939 Code), provides, so far as pertinent, that if "other property or money" (usually referred to by the courts as "boot") is received in an exchange otherwise qualifying as a tax-free exchange of stock for stock, then the gain, if any, to the recipient shall be recognized to the extent of such property or money. Section 356(a)(2), *supra*, p. 3 (like its predecessor, Section 112(c)(2) of the 1939 Code), provides that if a distribution of "boot" has the effect of the distribution of a dividend, then it shall be so taxed to the recipient, to the extent of "such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913."

It is not disputed that the consolidation of the Riggs Bank and the Trust Company was a reorganization within the purview of Section 354(a)(1), or that there was, in part, an exchange of stock for stock. It is also not disputed that the entire amount of cash received by the taxpayer ($2,025) constituted taxable gain to him under Section 356(a)(1). As to Section 356(a)(2), the cash distributed to the stockholders of the Trust Company as an incident of the consolidation ($450,000) was exceeded by the Trust Company's accumulated earnings and profits as of the date of consolidation ($909,671.49). The cash was distributed to Trust Company stockholders *pro rata* their holdings of Trust Company stock. The only question, therefore, is whether the distribution had the "effect of the distribution of a dividend" within the meaning of Section 356(a)(2).

The Court of Claims approached this question of dividend equivalence or "effect" as one of fact, to be decided in the light of all the circumstances of the case (Pet. 6a-9a). As in its earlier decision in *Idaho Power Co.* v. *United States*, 161 F. Supp. 807, certiorari denied, 358 U.S. 832, the court rejected the view that where "boot" is exceeded by available earnings and profits, the equivalent of a dividend is necessarily present without regard to other circumstances; in other words, it refused, as in *Idaho Power*, to read this Court's decision in *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, as establishing any such general rule of so-called automatic dividend equivalence. But the court concluded, upon a review of the facts, that the cash distribution here involved had the same effect, albeit by a circuitous route, as if the Trust Company had distributed available earnings and profits to its stockholders. Therefore, it held that the distribution was taxable as a dividend distribution under Section 356(a)(2).

Passing for the moment the court's interpretation of *Estate of Bedford*, we submit that it was entirely correct in concluding, on all the facts and circumstances of the case, that the cash distribution in question had the same net effect as an ordinary dividend distribution by the Trust Company and therefore was taxable as a dividend under Section 356 (a)(2). There was simply a *pro rata* cash distribution to Trust Company stockholders, exceeded by the Trust Company's available earnings and profits, which diminished the total assets contributed to the new consolidated corporation in the same manner as

if the Trust Company had declared and paid a dividend just prior to consolidation. Under these circumstances, the fact that the cash for distribution was actually set aside from funds of the Riggs Bank is, of course, immaterial. Precisely because the question is one of dividend effect—which is only reached because there is not a dividend *in form*—it is immaterial which party to a reorganization distributes the "boot." *Love* v. *Commissioner*, 113 F. 2d 236 (C.A. 3); *Commissioner* v. *Owens*, 69 F. 2d 597 (C.A. 5); *Rose* v. *Little Inv. Co.*, 86 F. 2d 50 (C.A. 5).

The taxpayer bases his attack (Pet. 5-7) upon the decision below on the mistaken notion that the motives behind a distribution of "boot" may determine whether or not such a distribution has the effect of a dividend. He urges that Congress was concerned with evasions and avoidance of tax, in enacting Section 356(a)(2) and its predecessors; that the purpose behind the distribution of the cash in question was not evasion or avoidance of dividend treatment, but the preservation of a capital structure free from unreasonable fractional shares which could not be readily marketed; and that this business purpose precludes dividend effect under the statute.

There is no warrant in the statute, its legislative history, or the decided cases for this subjective approach. When Congress has been concerned with a purpose to avoid taxes, as in dealing with unreasonable accumulations of corporate earning and in enacting fraud penalties, it has specifically defined the role that purpose or motive shall play. The gov-

erning statute here provides no role for purpose or motive in determining whether the net effect of certain transactions is the distribution of corporate earnings and profits *qua* dividends. The legislative history quoted by the taxpayer (Pet. 6-7) obviously refers to tax avoidance in terms of the objective net effect of corporate distributions, without regard to the motives behind such distributions. And it is this objective effect which the courts have sought to ascertain in dealing with distributions of "boot." [2]

Nor is the result here inequitable, as taxpayer suggests (Pet. 8). The courts have always been at special pains to preserve the identity of corporate earnings and profits until they have been taxed, first to the corporation, and then to the stockholders as dividends, when and as distributed. See, *e.g.*, *Commissioner* v. *Phipps*, 336 U.S. 410; *Commissioner* v. *Sansome*, 60 F. 2d 931 (C.A. 2), certiorari denied,

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[2] Generally, the only relevance of motive to distributions in reorganization is to determine whether there is a genuine commercial purpose germane to the business of one or more of the parties to the reorganization, for the distribution. If there is no such purpose, the purported reorganization will be disregarded as a sham. *Gregory* v. *Helvering*, 293 U.S. 465. But the existence of such a purpose, obviously, does not determine whether a distribution of "boot" has the effect of a dividend. Thus, in cases dealing with the cognate problem of dividend equivalence where stock is redeemed, it has been repeatedly held that the existence and nature of a business purpose is immaterial. *Northup* v. *United States*, 240 F. 2d 304 (C.A. 2); *Hirsch* v. *Commissioner*, 124 F. 2d 24, 29 (C.A. 9); *Smith* v. *United States*, 121 F. 2d 692, 696 (C.A. 3); *Boyle* v. *Commissioner*, 187 F. 2d 57 (C.A. 3); *Flanagan* v. *Helvering*, 116 F. 2d 937 (C.A. D.C.).

287 U.S. 667. The end result of the cash distribution here was a *pro rata* distribution to Trust Company stockholders, with a corresponding diminution of accumulated earnings and profits acquired by the new consolidated corporation. The fact that the Trust Company stockholders did not desire this distribution, and consented to it reluctantly, is irrelevant. They did consent in order to obtain advantages which were expected to flow from the consolidation. The taxpayer is not penalized therefor; he is taxed upon a distribution of cash which is admitted to be gain in its entirety and which, in and of tself, affected his stockholder status substantially as would an ordinary dividend, declared and paid in the usual way.

3. As noted (*supra*, p. 9), the Court of Claims refused in this case (as it had in *Idaho Power*) to read this Court's opinion in *Estate of Bedford* as authority for the so-called automatic dividend effect rule, *i.e.*, that a distribution of "boot" has the effect of a dividend if, without more, there are sufficient corporate earnings and profits. It took the view that all of the surrounding facts and circumstances must be taken into account, and not just the sufficiency *vel non* of available earnings and profits.

The taxpayer notes that this is the overt approach of the Court of Claims, but asserts that the court failed, in reality, to take the relevant facts into account (Pet. 4-5). Apparently, the taxpayer's view is that the court based its conclusion solely upon the undisputed existence of available earnings and profits, and hence applied the so-called automatic rule, notwithstanding its declarations to the contrary.

For the reasons already given, we believe that the court did take into account all relevant facts and circumstances, apart from the admitted sufficiency of corporate earnings to cover the distribution, and correctly concluded that the distribution had the effect of a dividend. However, even if the court had held that sufficiency of earnings and profits is the sole test of dividend effect, we submit that—in the light of *Bedford*—the court would not have erred as a matter of law.

In *Idaho Power*, unlike the instant case, the taxpayer was a corporation seeking a dividends-paid credit and hence contending that a "boot" distribution (called an exchange premium) had the effect of a dividend. In so contending, the taxpayer argued that *Bedford* was authority for the so-called automatic dividend equivalence test. The Government had for some thirteen years theretofore urged the same interpretation of *Bedford*, but without success; hence, to protect the revenue, the Government took a contrary position in *Idaho Power*, in effect urging that, if this construction was not to be accepted when advanced on behalf of the Government, it should not be accepted at the behest of taxpayers. Rejecting the so-called automatic test, the Court of Claims held that the distribution in question did not have the effect of a dividend and hence that the taxpayer was not entitled to the dividends-paid credit. The taxpayer thereupon filed a petition for a writ of certiorari (No. 236, O. T. 1958). In response, the Government filed a memorandum, urging that certiorari should be granted as to the "boot" distribution (the

exchange premium).[3] After reviewing the *Bedford* opinion in detail, the Government said (pp. 9-10):

> Despite the concluding reference to *Dobson*, it would seem—and the Government understood—that this Court was promulgating a rule of general applicability, i.e., that the availability of sufficient earnings and profits is the sole test of dividend effect under Section 112(c)(2). This construction was in harmony with the rationale, if not the square holding, of prior decisions. [Citing cases.]

Summarizing the adversities which this interpretation, as urged by the Government, had encountered in the courts, the Government's memorandum concluded (p. 13)—

> * * * the Government still finds it difficult, in view of the forthright language of *Bedford*, to square the reasoning of that decision with any other construction of Section 112(c)(2) than that the sufficiency of earnings and profits is the sole test of dividend effect.

Thereafter, on October 13, 1958, this Court denied certiorari in *Idaho Power*, 358 U.S. 832. Since the denial of certiorari of course imports nothing as to the merits, we submit—for the reasons set forth in the Government's memorandum in *Idaho Power*—that it is still an open question whether *Bedford* is au-

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[3] *Idaho Power* also involved an issue as to a redemption premium, and the Government opposed certiorari as to that issue.

thority for the so-called automatic dividend equivalence test. Hence, even if the Court of Claims had applied that test, which it did not, we would argue that a correct rule of law had been applied.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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